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No. 91-611

IN THE SUPREME COURT OF THE UNITED STATES
October Term, 1991

KEYTON E. BARKER AND PAULINE BARKER, *ET AL.*,
PETITIONERS,

VS.

STATE OF KANSAS, *ET AL.*,
RESPONDENTS.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF KANSAS

BRIEF FOR PETITIONERS

JOHN C. FRIEDEN
KEVIN M. FOWLER*
FRIEDEN, HAYNES & FORBES
400 SW 8th, Suite 409
Topeka, Kansas 66603
(913) 232-7266

* *Counsel of Record*

TERENCE A. LOBER
DAVIS, BEALL, MCGUIRE &
THOMPSON, CHARTERED
1117 Cherokee Street
Leavenworth, Kansas 66048
(913) 682-3822

KENTON C. GRANGER
RAYMOND L. DAHLBERG
ANGELA K. GREEN
NIEWALD, WALDECK &
BROWN, P.C.
9401 Indian Creek Parkway
Corporate Woods,
Building 40,Suite 550
Overland Park, Kansas 66225
(913) 451-1717

ROGER M. THEIS
9411 Shannon Way Court
Wichita, Kansas 67206
(316) 634-0418

Counsel for Petitioners

QUESTION PRESENTED

WHETHER THE KANSAS INCOME TAX ACT VIOLATES CONSTITUTIONAL OR STATUTORY PRINCIPLES OF INTERGOVERNMENTAL TAX IMMUNITY BY FAVORING RETIRED EMPLOYEES OF THE STATE AND ITS POLITICAL SUBDIVISIONS OVER RETIRED OFFICERS AND EMPLOYEES OF THE UNITED STATES ARMED FORCES.

PARTIES TO THE PROCEEDING

The parties to the proceeding in the Kansas Supreme Court were: (1) Petitioners Keyton Barker and Pauline Barker; William Richards, Sr. and Ollun E. Richards; Andrew J. Peele; Clarence Wolf and Flora B. Wolf; John G. Fowler and Carol B. Fowler; Leonard W. Williams and Loneta S. Williams; Anthony E. Corcoran; William J. Lober, Jr. and Marjorie E. Lober; Roger W. Clay and Betty J. Clay; Roger J. Olson and Nancy W. Olson; Leland W. Keister, Jr. and Patricia K. Keister; and Edward F. Kellogg and Renata O. Kellogg, for themselves and all others similarly situated;* and (2) Respondents State of Kansas; Kansas Department of Revenue; Secretary of Revenue of the State of Kansas; and Director of Taxation of the State of Kansas.

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* Petitioners and their counsel were designated by the district court to represent a certified class which consists of approximately 14,000 federal military retirees [and, where applicable, their joint taxpayer spouses] who have been subject to Kansas state income taxation during one or more tax years from 1984 through 1989. *See* J.A. at 50, 53. Petitioners were Appellants in the proceedings before the Kansas Supreme Court.

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OPINIONS BELOW

The opinion of the Kansas Supreme Court [Pet. App. at 1a-35a] is reported at 249 Kan. 186, 815 P.2d 46 (1991). The Memorandum Decision and Order of the District Court of Shawnee County, Kansas [Pet. App. at 36a-46a] is unreported.

JURISDICTION

The judgment of the Kansas Supreme Court was entered on July 12, 1991. Pet. App. at 3a. The petition for a writ of

certiorari was filed on October 10, 1991, and it was granted on November 27, 1991. 112 S.Ct. 576. The jurisdiction of this Court rests upon 28 U.S.C. § 1257(a).

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED

1. Pertinent text from the supremacy clause, U.S. Const., art. VI, cl. 2, is set forth in the Petition at 2.

2. The pertinent text of 4 U.S.C. § 111 provides:

> The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States . . . by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.

3. The pertinent text of Kansas statutes and regulations is set forth in Petition Appendix C at 47a-60a.

STATEMENT

In *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (Mar. 28, 1989), this Court applied settled principles of intergovernmental tax immunity to invalidate a Michigan income tax exemption scheme which favored retired state and local employees over retired federal employees. *Id.* at 817. Petitioners allege that the Kansas income tax exemption scheme suffers from these same constitutional infirmities by favoring retired state and local employees over retired members of the United States Armed Forces.

The Kansas Income Tax Act [Kan.Stat.Ann. § 79-3201 *et seq.* ("KITA")], utilizes federal adjusted gross income as the starting point for determining an individual's state income tax

liability. Kan.Stat.Ann. § 79-32,117(a) (Supp. 1990).[1] Since federal adjusted gross income includes "[a]nnuities" and "[p]ensions" without regard to source, 26 U.S.C. § 61(a)(9) and (11), all types of nondisability retirement benefits paid by federal, state and local governments would be taxable under Kan.Stat.Ann. § 79-32,117(c) (Supp. 1990).

In accordance with Kan.Stat.Ann. § 79-32,117(c), all retirement benefits paid by the State and its political subdivisions are excluded from Kansas adjusted gross income through exemptions identified by the source of compensation. *See* Kan.Stat.Ann. § 79-32,117(c)(ii), (ix), and (xiii) (Supp. 1990).[2] With respect to retirement benefits paid by the United States, however, this statute exempts benefits from only two specified federal sources: "[a]mounts received as annuities under the federal civil service retirement system, from the civil service retirement and disability fund," Section 32,117(c)(vii); and "[a]mounts

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1 Federal "adjusted gross income" consists of gross income [as defined in 26 U.S.C. § 61(a)] minus specified deductions. 26 U.S.C. § 62 (1988).

2 Most benefits paid to retired employees of Kansas and its political subdivisions are exempt as "amounts received which are included in federal adjusted gross income but which are specifically exempt from Kansas income taxation under the laws of the state of Kansas." Kan.Stat.Ann. § 79-32,117(c)(ii) (Supp. 1990). *See* Kan.Stat.Ann. § 12-111a (1982), § 12-5005 (Supp. 1990), § 13-14a10 and § 14-10a10 (1982) [exempting benefits paid to retired policemen and firemen under local retirement plans]; Kan.Stat.Ann. § 20-2618 (Supp. 1990) [exempting benefits paid under the retirement system for state judges]; Kan.Stat.Ann. § 72-1768a and § 72-17,122 [exempting benefits paid under the school employee's supplemental retirement system]; Kan.Stat.Ann. § 74-4923(b) (Supp. 1990) [exempting retirement benefits paid under the Kansas Public Employees Retirement System ("KPERS") and Kansas Police and Fireman's Retirement System ("KP&F")]; Kan.Stat.Ann. § 74-4978g (Supp. 1990) [exempting highway patrol pension fund benefits payable under KP&F]; Kan.Stat.Ann. § 74-49,105 [exempting benefits paid under the official court reporters retirement system]. *See also* Kan.Stat.Ann. § 79-32,117(c)(ix) [exempting benefits paid to retired city employees] and § 79-32,117(c)(xiii) (Supp. 1990) [exempting benefits paid to retired employees of boards of public utilities].

received by retired railroad employees as a supplemental annuity under the provisions of 45 U.S.C. 228b(a) and 228c(a)(1) *et seq.*," Section 32,117(c)(vii).[3] All other federal retirement benefits, including military retired pay, are subject to Kansas income taxation.[4]

Petitioners are designated representatives of a class of approximately 14,000 retired members of the United States Armed Forces [and, where applicable, their joint taxpayer spouses] whose military retired pay has been subject to Kansas income taxation during one or more tax years from 1984 through 1989. J.A. at 53, 56; Pet. App. at 6a. On April 17, 1989, in the wake of *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989), several named Petitioners initiated two class actions alleging that the Kansas income tax scheme violates 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity because it discriminates in favor of state and local government retirement

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[3] Retired members of the United States Armed Forces "62 years of age and older"" are "entitled to claim a tax credit in an amount of $120" against the Kansas income tax on their federal military retirement benefits. Kan.Stat.Ann. § 79-32,111b(a) (1989).

[4] In addition to military retired pay, Kansas also taxes the retirement benefits paid by the United States to: Public Health Service ["PHS"] retirees paid under 42 U.S.C.A. § 212 (West 1991); National Oceanic and Atmospheric Administration ["NOAA"] retirees paid under 33 U.S.C.A. § 853o (West 1986 and Supp. 1991); Central Intelligence Agency ["CIA"] retirees paid under the Central Intelligence Agency Retirement and Disability Act of 1964 for Certain Persons, Pub. L. 88-643, 78 Stat. 1043 (Oct. 13, 1964), as amended [50 U.S.C.A. § 403 note (West 1991)]; Foreign Service retirees paid from the Foreign Service Retirement and Disability Fund, 22 U.S.C.A. § 4041 *et seq.* (West 1990 and Supp. 1991); retired Justices and Judges of the United States paid under 28 U.S.C.A. § 371 (West 1968 and Supp. 1991); retired Claims Court judges paid under 28 U.S.C.A. § 178 (West Supp. 1991); and retired bankruptcy judges and magistrates paid under 28 U.S.C.A. § 377 (West Supp. 1991). *See* Kan.Stat.Ann. § 79-32,117(c) [no exemption for retirement benefits paid from these federal sources]; Pet. App. at 29a.

benefits. J.A. at 3-6, 9-12.[5] All Petitioners paid Kansas income taxes on their military retired pay during one or more tax years at issue. R. at 1055, 1069, 1083, 1109, 1129-1130, 1138, 1148, 1152-1153, 1164, 1172, 1181-1182, 1190.

On February 23, 1990, Petitioners moved for summary judgment on the question of liability, contending in relevant part that KITA unconstitutionally discriminates in favor of state and local government retirees and against federal military retirees based on the source of their retirement compensation. J.A. at 57. In opposition, Respondents argued that differential taxation of military retired pay under KITA is constitutional because it is directly related to and justified by substantial differences between the classes of retirees. R. at 1437-68.

On October 31, 1990, the district court rejected Petitioners' constitutional challenge and entered judgment *sua sponte* upholding the Kansas differential tax scheme. Pet. App. at 36a-46a. Relying primarily upon federal decisions which have characterized military retired pay as current compensation for purposes unrelated to taxation, the court reasoned that "there are substantial differences" between the classes which "justifies the disparate tax treatment" of military retirees. *Id.* at 41a-43a. The district court accordingly held that "the Kansas Income Tax Act is not unconstitutional nor in violation of 4 U.S.C. § 111." *Id.* at 44a-45a. Petitioners timely appealed. J.A. at 70.[6]

On July 12, 1991, the Kansas Supreme Court affirmed in

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[5] These lawsuits were subsequently consolidated in the District Court of Shawnee County, Kansas [J.A. at 33-34], and certified upon Petitioners' motion as a class action [J.A. at 48-49, 56]. Since *Barker* became the lead case following consolidation, all citations to the record of proceedings below rely upon the *Barker* Record.

[6] This case was later transferred from the Kansas Court of Appeals to the Kansas Supreme Court under the provisions of Kan.Stat.Ann. § 20-3017. Pet. App. at 5a; *see also* Kansas Supreme Court Order (filed Nov. 19, 1990).

a published opinion upholding the state's discriminatory tax scheme. Pet. App. at 1a-35a. In the court's view, differential taxation of military retirement benefits in Kansas is directly related to and justified by the "federal cases holding that military retirement pay is reduced compensation for reduced current services" and the "noncontributory" nature of the military retirement system. Pet. App. at 1a, 3a, 30a, 26a. Based on this reasoning, the Kansas Supreme Court held that the "discriminatory tax" is constitutional because it satisfies the requirements of *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989). Pet. App. at 35a, 1a and 3a.

SUMMARY OF THE ARGUMENT

The Kansas Income Tax Act [Kan.Stat.Ann. § 79-3201, *et seq.* ("KITA")] violates controlling principles of intergovernmental tax immunity by giving preferential treatment to retired employees of the State and its political subdivisions over retired officers and employees of the United States Armed Forces because of the source of their retirement pay or compensation. *See Davis v. Michigan Dept. of Treasury*, 489 U.S. at 817. The statute which creates the discriminatory classification in issue, Kan.Stat.Ann. § 79-32,117 (Supp. 1990), does not discriminate against federal military or civilian retirees because of any significant differences in their compensation or retirement systems; rather, it discriminates against them because they receive retirement pay from the Federal Government instead of the State or its political subdivisions. The offensive nature of this statute is vividly illustrated by the reality that these federal military and civilian retirees "would not be taxed at all if [their employer] were the State or one of its political subdivisions instead of the Federal Government." *Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U.S. 376, 382 (1960).

While Kansas generally taxes the income of its residents, all retirement benefits paid by the State and its political subdivisions are exempt from such taxation by source of compensation. *See* Kan.Stat.Ann. § 79-32,117(c)(ii), (ix), (xiii)

(Supp. 1990); *supra* at 3 and n. 2. However, pursuant to Kan.Stat.Ann. §§ 79-32,116 (1989) and 79-32,117(a) (Supp. 1990), all retirement benefits paid by the United States, including military retired pay, are subject to taxation except civil service annuities and railroad retirement supplemental annuities, which are exempt under Kan.Stat.Ann. §§ 79-32,117(c)(vii) and (viii) (Supp. 1990).

Since "Kansas income tax exemptions" for retirement income "are identified strictly by source" of compensation, Pet. App. at 26a, the Kansas tax system unlawfully favors all retired employees of the State and its political subdivisions over all retired officers and employees of the United States, including military retirees, who receive nondisability retirement benefits from any federal source which is not specifically recognized as the basis for an exemption.[7] This differential tax scheme discriminates against all such retired federal officers and employees "because of the source" of their "pay or compensation" and, therefore, violates the nondiscrimination clause of 4 U.S.C. § 111 as well as the constitutional doctrine of intergovernmental tax immunity. *See Davis*, 489 U.S. at 810, 813-814, 817.[8]

The Kansas Supreme Court's attempt to justify this "discriminatory tax" [Pet. App. at 35a] on the basis that military

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[7] While exemptions for federal civil service annuities and railroad retirement supplemental annuities are exceptions to the general taxability of federal retirement benefits under KITA which "reduce the extent of the discrimination created by" the Kansas tax scheme, "they obviously do not eliminate it." *Cf. Phillips Chemical Co.*, 361 U.S. at 381 n. 6.

[8] *Cf. Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392, 397-399 (1983) [invalidating a Tennessee bank tax which impermissibly discriminated "in favor of securities issued by Tennessee and its political subdivisions and against federal obligations * * * * by including in the tax base income from federal obligations while excluding income from otherwise comparable state and local obligations."]; *Phillips Chemical Co.*, 361 U.S. at 383-387 [invalidating a Texas lease tax which impermissibly taxed lessees of federal property while exempting lessees of exempt property owned by the State and its political subdivisions].

retirees receive current compensation and participate in a noncontributory retirement system is unavailing. Although inconsistent tax treatment may be permissible if it is "directly related to and justified by 'significant differences between the two classes,'" *Davis*, 489 U.S. at 816 [citation omitted], the Kansas court reached an erroneous conclusion, in part, because it did not examine "'the whole tax structure of the state'" or "focus on the nature of the classification" erected by the statutory tax scheme. *Phillips Chemical Co.*, 361 U.S. at 383 [quoting *Tradesmens Nat. Bank of Oklahoma City v. Oklahoma Tax Commission*, 309 U.S. 560, 568 (1940)]. When viewed in its entirety, however, the applicable tax structure is solely dependent upon "source" of retirement pay and this single statutory classification does not account for any alleged differences in the nature or funding of retirement compensation. Kansas accordingly discriminates against many forms of federal civilian retirement pay -- none of which is current compensation and most of which is funded through contributory retirement systems -- under the same source-related classification which results in the taxation of military retired pay. While KITA operationally creates only a single classification as the basis of differential treatment, the opinion below draws unwarranted distinctions which are neither recognized by the statutory scheme nor uniformly applicable to all affected government employees.

The Kansas Supreme Court further erred in relying upon nontax cases such as *McCarty v. McCarty*, 453 U.S. 210 (1981), and *United States v. Tyler*, 105 U.S. 244 (1881), to conclude that military retired pay must be characterized and treated for income tax purposes as "reduced current compensation for current reduced services." Pet. App. at 30a, 17a-24a. Regardless of its characterization or treatment for other distinct purposes, military retired pay is taxable under 26 U.S.C. § 61(a)(11) (1988) as ordinary pension income when received. *See McCarty*, 453 U.S. at 214 n. 7 [citing 26 U.S.C. § 61(a)(11); 26 C.F.R. § 1.61-11 (1980)]. Because Kan.Stat.Ann. § 79-32,117(a) incorporates this federal tax treatment of military retired pay in defining the State tax base, military retired pay is taxable under KITA as "pension"

income, 26 U.S.C. § 61(a)(11), rather than as wages, salaries or other compensation for current service. The specific statutory basis for taxing military retired pay as pension income, therefore, rejects compensation for current service as a bona fide reason or justification for discrimination.

In addition to the treatment of military retired pay in the same manner as "pensions" under 26 U.S.C. § 61(a)(11), other provisions of federal and state law relevant to taxation consistently treat military retired pay in the same manner as other pensions.[9] It is, therefore, inconceivable that differential treatment under KITA is directly related to any material differences in nature of military retired pay or that Congress has consented to such discriminatory taxation. Although military retired pay is not significantly different in character, at least for tax purposes, from other forms of retirement income, *cf. McCarty*, 453 U.S. at 223 n. 16 [military retired pay bears features of deferred compensation], the Kansas tax scheme violates 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity by discriminating against federal military retirees because of the "source" of their pay or compensation.

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[9] For example, the Federal Insurance Contributions Act ["FICA"] levies a tax on "wages" for employment, but it does not tax military retired pay or any other form of pension income. *See* 26 U.S.C.A. §§ 3121(a)(5), (i)(2), (m) and (v)(3) (West Supp. 1991). Similarly, although wages for employment are generally subject to involuntary income tax withholding, state income taxes may not be withheld from military retired pay unless the taxpayer "voluntarily requests such withholding in writing." *See* 10 U.S.C.A. § 1045(a) (West Supp. 1991). Under the Internal Revenue Code, military retirees who fund survivor annuities through reductions in retired pay are also extended the same tax treatment as civil service retirees and other retirees under qualified pension plans. *See* 26 U.S.C. § 122(a) (1988) [gross income does not include such reductions in retired pay]; H.R. Rep. No. 1118, 89th Cong., 1st Sess. 4-5 (1965). Likewise, contributions to an Individual Retirement Account ["IRA"] made with military retired pay do not qualify for an IRA deduction because it is treated as pension income. *See* 26 U.S.C. § 219(f)(1) (Supp. 1989); Weinstein, 6 *Mertens Law of Federal Income Taxation* § 25C.12 at 58 (1988); Pet. App. at 24a-25a.

The Kansas Supreme Court also erroneously suggested that the "noncontributory" nature of the military retirement system might justify differential treatment of federal military retirees because "[t]he federal government's method of funding" prevents Kansas from taxing any portion of their benefits before receipt. Pet. App. at 26a. If Kansas truly intended to discriminate on this basis rather than by source of compensation, state retirement benefits funded without any taxable employee contributions would be taxed upon receipt, but they are exempt. *See* Kan.Stat.Ann. § 74-4923(b) and § 74-4925(1)(a) and (4) (Supp. 1990), *with Davis*, 489 U.S. at 817. Likewise, all federal retirement benefits funded with employee contributions would be exempt upon receipt, but they are not. *See* Kan.Stat.Ann. § 79-32,117(a) and (c) (Supp. 1990). *See Davis*, 489 U.S. at 817. On the other hand, differential taxation of federal retirement pay on the basis that the officers or employees did not contribute to any retirement fund before retirement would clearly violate 4 U.S.C. § 111; this purported rationale is merely another way of stating that discrimination is based on the fact that the United States is the exclusive "source of the pay or compensation."[10] Moreover, the manner in which the United States funds its retirement system does not implicate any proper domestic concerns of Kansas, and any attempt to rely upon this federal policy choice to justify tax discrimination against military retirees would impermissibly trench upon or interfere with the constitutional prerogatives of Congress. *Cf. McCarty*, 453 U.S. at 232-236 *with Phillips Chemical Co.*, 361 U.S. at 385.

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10 While differences in funding methods is not the reason for discrimination under KITA, it should also be recognized that employer contributions made by the State and its political subdivisions, as well as the investment growth in their retirement plans, are never subject to Kansas income taxation. Therefore, the blanket exclusion of state and local retirement benefits from the Kansas tax base unjustifiably exceeds any limited exemption which may be necessary to avoid double taxation of employee contributions.

ARGUMENT

THE KANSAS INCOME TAX ACT VIOLATES GOVERNING PRINCIPLES OF INTERGOVERNMENTAL TAX IMMUNITY BY FAVORING RETIRED EMPLOYEES OF THE STATE AND ITS POLITICAL SUBDIVISIONS OVER RETIRED OFFICERS AND EMPLOYEES OF THE UNITED STATES ARMED FORCES.

Under codified principles of intergovernmental tax immunity, state and local taxing authorities are "unmistakably" prohibited from imposing taxes which discriminate against active and retired officers or employees of the United States "because of the source" of their "pay or compensation." 4 U.S.C. § 111. *See Davis*, 489 U.S. at 810. This statutory prohibition "closely parallels" and "is coextensive with" the constitutional doctrine of intergovernmental tax immunity which bars "taxes that 'operat[e] so as to discriminate against the Government or those with whom it deals.'" *Davis*, 489 U.S. at 812-813 [quoting *United States v. City of Detroit*, 355 U.S. 466, 473 (1958)]. Therefore, "'[t]he imposition of a heavier tax burden on [those who deal with one sovereign] than is imposed on [those who deal with the other]'" violates these governing principles unless "the inconsistent tax treatment is directly related to, and justified by, 'significant differences between the two classes.'" 489 U.S. at 815-816 [quoting *Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U.S. 376, 383-385 (1960)].

In evaluating whether a state tax scheme unlawfully discriminates against the United States or those with whom it deals, this Court has made clear that reviewing courts must examine "'the whole tax structure of the state'" and "focus on the nature of the classification" erected by statute. *Phillips Chemical Co.*, 361 U.S. at 383 [quoting *Tradesmens Nat. Bank of Oklahoma City v. Oklahoma Tax Commission*, 309 U.S. 560, 568 (1940)]. Such examination is necessary to identify the actual basis for differential treatment and to insure that proffered rationales for inconsistent treatment are not merely pretexts for impermissible

discrimination. *See Davis*, 489 U.S. at 816-817; *Phillips Chemical Co.*, 361 U.S. at 383-385. Indeed, the elevated standard of justification required to protect the interests of the United States would be substantially emasculated without these objective limitations on the proper form of inquiry.

Respondents expressly concede "that military retirees are entitled to receive the protection of 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity." Respondents' Brief in Opposition at 6, 11. Respondents also acknowledge that the State of Kansas levies an income tax on federal military retired pay while exempting retirement benefits paid by the State and its political subdivisions. *Id.* at 4. Therefore, the dispositive issue presented on writ of certiorari is whether the Kansas differential income tax scheme truly complies with the direct relationship and justification requirements articulated in *Davis*, 489 U.S. at 816, and *Phillips Chemical Co.*, 361 U.S. at 383-385.

In *Davis*, this Court struck down a differential exemption scheme under the Michigan Income Tax Act which "violate[d] principles of intergovernmental tax immunity by favoring retired state and local government employees over retired federal employees." 489 U.S. at 817. Given the statutory manner in which Michigan exempted retirement income by source of compensation, the retirement benefits of retired state and local government employees were exempt from state taxation while the benefits received by retired federal employees were not. *Id.* at 806 and n.2. However, Congress unmistakably forbids state taxation which discriminates against retired federal officers or employees "because of the source of the pay or compensation." 4 U.S.C. § 111. *See Davis*, 489 U.S. at 812. Reasoning that Michigan's tax system "discriminate[d] on the basis of the source of [retirement] benefits," and that "[t]he State's interest in adopting the discriminatory tax" cannot justify differential treatment, *Davis* concluded that Michigan's exemption scheme offended controlling precepts of federal law. *Id.* at 816-817. This analysis is equally applicable here.

A. All Government Retirees Are Similarly Situated For Purposes of Taxation and "Presumably Should be Taxed Alike."

Despite the importance of determining whether federal, state and local government retirees are "similarly situated" for tax purposes, the opinion below does not directly address or resolve this initial issue. Instead, the Kansas Supreme Court erroneously viewed the threshold question of whether the classes are "similarly situated" as synonymous with the ultimate question of whether differential taxation is justified by "significant differences" between the classes. *See, e.g.*, Pet. App. at 15a-17a. This mistaken interpretation, however, directly conflicts with the analytical framework applied in *Phillips Chemical Co.*, 361 U.S. at 381-385, and it disregards the presumption of equal taxation applicable in cases involving intergovernmental tax immunity. *Id.* at 381.

As a threshold matter, Petitioners submit that all retired officers or employees of the United States are "similarly situated" with state and local government retirees for purposes of the tax immunity doctrine. Upon retirement, each civilian and military officer or employee: leaves active government service; acquires "retired" status; and receives nondisability retirement pay based on years of past service and highest qualifying rank or level of compensation attained.[11] Likewise, no such retired officer or

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[11] "Members of the Armed Forces who serve for a specified period, generally at least 20 years, may retire with retired pay. 10 U.S.C. § 3911 *et seq.* (1982 ed. and Supp. V) (Army); § 6321 *et seq.* (Navy and Marine Corps) (1982 ed. and Supp. V); § 8911 *et seq.* (Air Force) (1982 ed. and Supp. V). The amount of retirement pay a veteran is eligible to receive is calculated according to the number of years served and the rank achieved." *Mansell v. Mansell*, 490 U.S. 581, 583 (1989). *See* 10 U.S.C.A. §§ 1401, 1406 and 1407 (West 1983 and Supp. 1991).

Federal civil servants who meet certain combined age and years of service requirements may retire and immediately begin receiving retirement benefits. *See* 5 U.S.C.A. § 8336 (West 1980 and Supp. 1991). For example,

employee continues to receive salary or wages from the government based on any active or affirmative duties which must be performed in retirement. *See, e.g.*, 37 U.S.C. § 204(a), § 402(a), § 403(a) (1988) [military retirement terminates the right to active duty pay and allowances]. All government retirees are, therefore, "similarly situated" since they share these common characteristics and they *"presumably should be taxed alike."* *Phillips Chemical Co.*, 361 U.S. at 381 [emphasis added].[12]

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federal employees who complete "20 years of service as a law enforcement officer or firefighter" may retire at 50 years of age with a full retirement annuity. 5 U.S.C.A. § 8336(c)(1) (West 1980). For all federal civil servants, "the amount of benefits received in retirement is based and computed upon the individual's salary and years of service. 5 U.S.C. § 8339(a) [5 U.S.C.S. § 8339(a)]." *Davis*, 489 U.S. at 808. Other federal retirement systems for civilian employees of the United States not covered by the federal civil service retirement system also share these same features.

By comparison, employees of Kansas and its political subdivisions may generally retire with full benefits after at least 10 years of service upon reaching a specified age or at any age with the completion of 40 years of service. *See, e.g.*, Kan.Stat.Ann. § 74-4914(1) (Supp. 1990). For example, police officers and firefighters may retire with full benefits at age 55 following 20 years of service or at age 50 following 25 years of service. Kan.Stat.Ann. §§ 74-4957(1) and (3), 74-4955a(1) and 74-4957a(1) (Supp. 1990). For all such state and local government retirees, the amount of benefits received in retirement is based on and calculated in accordance with years of service and final average salary. *See, e.g.*, Kan.Stat.Ann. §§ 74-4915(1) and 74-4958(1) (Supp. 1990).

12 As this Court observed in *Davis*, 4 U.S.C. § 111 was enacted as part of the Public Salary Tax Act of 1939 to "impose federal income tax on the salaries of all state and local government employees" and to authorize the imposition of nondiscriminatory state taxes on the pay or compensation of all federal officers and employees. 489 U.S. at 810-812. *See also* S. Rep. No. 112, 76th Cong., 1st Sess. 1 (1939) ["Title I of the bill subjects to Federal income tax for taxable years beginning after December 31, 1938, the compensation of all State and local officers and employees and grants consent to the States to tax the compensation received after December 31, 1938, by Federal officers and employees."]. By this simultaneous action, Congress plainly intended all federal, state and local government employees to be equally subject to the burdens of both federal and state income taxation. *Davis*, 489 U.S. at 812 [Congress was "concerned that considerations of fairness demanded equal tax treatment for state

"Because 'the Government's interests must be weighed in the balance,'" the presumption that federal retirees are entitled to equal tax treatment places a substantial burden on state taxing authorities to establish that differential taxation is "directly related to and 'justified by significant differences'" between the favored and the disfavored classes of taxpayers. *Davis*, 489 U.S. at 815-817; *Phillips Chemical Co.*, 361 U.S. at 383-385. In direct conflict with these settled principles, however, the opinion below improperly applied a state presumption that KITA's differential taxation of federal military retirees is constitutional and resolved "all doubts . . . in favor of its validity." Pet. App. at 9a. *Cf. King v. St. Vincent's Hospital*, No. 90-889, slip op. at 6 n.9 (U.S., filed Dec. 16, 1991) ["provisions for benefits to members of the Armed Services are to be construed in the beneficiaries' favor," citing *Fishgold v. Sullivan Drydock & Repair Corp.*, 328 U.S. 275, 285 (1946)].

B. The Kansas Tax Scheme Is Substantially Similar to the Michigan Scheme Invalidated in *Davis*.

Like Michigan's offensive tax scheme, KITA "defines taxable income in a manner that excludes all retirement benefits received from the State or its political subdivisions, but includes most other forms of retirement benefits." *Davis*, 489 U.S. at 806. *See* Kan.Stat.Ann. § 79-32,116 (1989); Kan.Stat.Ann. §§ 79-32,117(a) and (c)(ii), (ix), (xiii) (Supp. 1990); Pet. App. at 7a-8a, 29a. However, all retirement benefits paid by the United States -- including military retired pay -- are subject to tax except civil

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and federal employees"]. *See also*, 84 CONG. REC. 1306 (1939) (statement of Rep. Cochran) [the Act is an "effort to equalize the tax burdens by requiring State employees to pay a Federal income tax and the Federal employees to pay State income tax"]; *Id.* at 1313 (statement of Rep. Disney) ["The prime object of the bill is . . . to equalize taxes"]; *Id.* at 1318 (statement of Rep. Dingell) ["the bill provides for reciprocal taxation on an equality basis"]; *Id.* at 1329 (statement of Rep. Cooper) ["the consent of Congress to tax Federal employees * * * * is based upon equality and fairness"]. Therefore, members of the class of government retirees are similarly situated for tax purposes.

service annuities and railroad retirement supplemental annuities, which are exempt under Kan.Stat.Ann. §§ 79-32,117(c)(vii) and (viii) (Supp. 1990). Since all "Kansas income tax exemptions are identified strictly by source" of retirement pay or compensation, Pet. App. at 26a, the differential exemption scheme erected by KITA -- which discriminates between retired government employees solely because of the "source" of their compensation -- is materially indistinguishable from Michigan's unlawful exemption scheme invalidated in *Davis*. *Cf.* Kan.Stat.Ann. § 79-32,117(c) (Supp. 1990) *with* Mich. Comp. Laws Ann. §§ 206.30(1)(f)(i) and (iv) (Supp. 1988).[13]

The Kansas Supreme Court considered the "net result" of this source-related Kansas exemption scheme to be that "benefits paid to federal civil service, railroad, state and local government retirees are exempt from Kansas income tax while benefits paid to military retirees are not." Pet. App. at 10a-11a. This comparison, however, obscures the true nature and extent of the differential taxation at issue. Because the opinion below did not follow the unequivocal mandate to examine "'the whole tax structure of the state'" and "focus on the nature of the classification," *Phillips Chemical Co.*, 361 U.S. at 383 [citation omitted], its selective approach ignores the harsh reality that Kansas taxes every federal retiree who receives retirement pay

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[13] While Michigan did not exempt any federal retirement benefits from state income tax, all federal retirees were given a specific deduction of "'not more than $7,500.00'" on each single tax return and "'not more than $10,000.00'" on each joint tax return. *Davis*, 489 U.S. at 806 n.2 [quoting Mich. Comp. Laws Ann. § 206.30(1)(f)(iv) (Supp. 1988)]. Since retired military and civilian employees of the United States are generally required to pay Kansas income tax, without the benefit of comparable deductions, they bear an even greater tax burden than their retired counterparts did under Michigan's unlawful tax scheme. Therefore, while exemptions for federal civil service annuities and railroad retirement supplemental annuities "reduce the extent of the discrimination created by" the Kansas differential tax scheme, "they obviously do not eliminate it." *Cf. Phillips Chemical Co.*, 361 U.S. at 381 n.6 [taxation of certain types of public property owned by Texas and its political subdivisions reduced, but obviously did not eliminate, discrimination against the United States and its lessees].

from any federal source other than the Civil Service Retirement and Disability Fund.

In addition to military retired pay, Kansas also refuses to exempt the retirement pay received by all other federal retirees, including: Public Health Service ["PHS"] retirees paid under 42 U.S.C.A. § 212 (West 1991); National Oceanic and Atmospheric Administration ["NOAA"] retirees paid under 33 U.S.C.A. § 853o (West 1986 and Supp. 1991); Central Intelligence Agency ["CIA"] retirees paid under the Central Intelligence Agency Retirement and Disability Act of 1964 for Certain Persons, Pub. L. 88-643, 78 Stat. 1043 (Oct. 13, 1964), as amended [50 U.S.C.A § 403 note (West 1991)]; Foreign Service retirees paid from the Foreign Service Retirement and Disability Fund, 22 U.S.C.A. § 4041 *et seq.* (West 1990 and Supp. 1991); retired Justices and Judges of the United States paid under 28 U.S.C.A. § 371 (West 1968 and Supp. 1991); retired Claims Court judges paid under 28 U.S.C.A. § 178; and retired bankruptcy judges and magistrates paid under 28 U.S.C. § 377 (West Supp. 1991). *See* Kan.Stat.Ann. § 79-32,117(c) [no exemption for retirement benefits paid from these federal sources]; Pet. App. at 29a. Since these federal retirees are similarly situated with all other government retirees for tax purposes, the treatment of their federal retirement pay under the same statutory classification which discriminates against military retirees cannot be ignored in any objective evaluation of the Kansas source-related exemption scheme.

The opinion below, however, expressly refused to consider the differential tax treatment of these other federal retirees for the stated reason that they do not have "*exactly the same characteristics* as the class of military retirees . . .." Pet. App. at 29a [emphasis added]. This refusal fundamentally conflicts with the command "to determine how other taxpayers *similarly situated* are treated," *Phillips Chemical Co.*, 361 U.S. at 383 [emphasis added], and it impermissibly limits the constitutional inquiry to those government retirees who have "exactly the same characteristics." Since no two classes of federal, state or local

government retirees have "exactly the same characteristics," the Kansas Supreme Court employed an unreasonably narrow standard of review which substantially eviscerates the nondiscrimination clause of 4 U.S.C. § 111 and the constitutional doctrine of intergovenmental tax immunity. If this improper mode of analysis is not repudiated immediately, it may become open season for discrimination against retired federal employees on the basis of purely superficial differences between retirees who are in privity with state and local governments and those who are not. As this Court recently observed, "[t]he danger that a State is engaging in impermissible discrimination against the Federal Government is greatest when the State acts to benefit itself and those in privity with it." *Davis*, 489 U.S. at 815 n.4.[14]

By refusing to consider the disparate treatment of other similarly situated federal retirees, the Kansas Supreme Court also ignored the nature of the classification erected by the Kansas tax statute, *contra Phillips Chemical Co.*, 361 U.S. at 383, which relies exclusively upon the particular government "source" of retirement pay or compensation in determining whether benefits will be excluded from the Kansas tax base. This highly selective approach demonstrates that the Kansas court simply turned a blind eye -- under inappropriate state standards of review -- on patently unlawful discrimination. Although many forms of federal civilian retirement benefits taxed by Kansas are not compensation for service in retirement or derived from noncontributory retirement systems, they are subject to the same disparate treatment under the

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[14] The State of Kansas and its political subdivisions are in privity with all of their active and retired employees who participate in a state or local government retirement system. *See Shapiro v. Kansas Public Employees Retirement System*, 216 Kan. 353, Syl. ¶ 1, 532 P.2d 1081 (1975) ["State retirement systems create contracts between the state and its employees who are members of the system."]. *See also Brazelton v. Kansas Public Employees Retirement System*, 227 Kan. 443, 448-449, 607 P.2d 510 (1980) [the rights to retirement benefits under KPERS and KP&F are contractual in nature]. This continuing contractual relationship also demonstrates that state and local government employees do not sever the connection with their employer upon retirement.

same discriminatory classification as military retired pay. Since the opinion below examined and considered the treatment of all federal, state and local government retirees whose benefits are exempt from Kansas income taxation, its refusal to examine and consider the tax treatment of all federal retirees who are adversely affected by the differential classification is inconsistent, indefensible, and contrary to the classification established by the statute itself.

Nevertheless, comprehensive examination of the Kansas tax structure applicable to all government retirees clearly demonstrates that KITA favors all categories of state and local government retirees over virtually all categories of federal retirees based on the source of their retirement compensation.[15] Kan.Stat.Ann. § 79-32,117 (Supp. 1990) does not discriminate against federal retirees because of any significant differences in their compensation or retirement systems; rather, it discriminates against them solely because they receive retirement pay from the Federal Government instead of the State or its political subdivisions. Indeed, retired officers and employees of the United States whose retirement pay is subject to the Kansas income tax "would not be taxed at all if [their employer] were the State or one of its political subdivisions instead of the Federal Government." *Phillips Chemical Co.*, 361 U.S. at 382. The differential exemption scheme in Kansas is, therefore, substantially similar to the Michigan tax system repudiated by this Court, and it deserves the same fate. *See Davis*, 489 U.S. at 806, 814-817.

C. Differential Taxation of Federal Military Retirees Is Not "Directly Related to" Any Significant Differences Between the Classes of Favored and Disfavored Goverment Retirees.

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15 While source-related exemptions for retired federal civil servants and railway employees may "reduce the extent of the discrimination" created by KITA, "they obviously do not eliminate it." *Cf. Phillips Chemical Co.*, 361 U.S. at 381 n. 6.

Relying upon *Davis* and certain federal cases having nothing to do with taxation or intergovernmental tax immunity, the Kansas Supreme Court concluded that differential taxation of military retirement pay is directly related to its character as "reduced current compensation for reduced current services." Pet. App. at 30a. The opinion below reasoned that there is a "direct relationship" between differential taxation and the alleged nature of retirement pay because "an evenhanded application of the rationale for taxing all members of one class (military retirees) does not result in taxation of some members of the other class (state and local government retirees)." Pet. App. at 28a. These conclusions, however, are patently erroneous and must be rejected.

The direct relationship test mandates that statutory classifications which result in differential taxation must be "based on" significant differences between all members of the favored class of taxpayers and the disfavored class of taxpayers. *Phillips Chemical Co.*, 361 U.S. at 384. This requirement is not satisfied, however, unless the significant differences offered as justification furnish the actual reason for discrimination. *Davis*, 489 U.S. at 816-817. To paraphrase *Davis*, *"[a] tax exemption truly intended to account for differences in retirement benefits would not discriminate on the basis of the source of those benefits [as Kansas does];* rather, it would discriminate on the basis of [asserted differences in retirement benefits]." *Id.* at 817 [emphasis added]. Therefore, a state tax exemption scheme which erects a source-related classification cannot survive scrutiny unless the proffered rationale for discrimination uniformly justifies an exemption for all retirees in the favored class and it uniformly justifies taxation of all retirees in the disfavored class. *Davis*, 489 U.S. at 817; *Phillips Chemical Co.*, 361 U.S. at 383-385.

Notwithstanding the existence of nontax cases such as *McCarty v. McCarty*, 453 U.S. 210 (1981), and *United States v. Tyler*, 105 U.S. 244 (1881), which view military retired pay as reduced current compensation for certain distinct purposes, the opinion below fatally ignores the fact that KITA's source-related classification creates a *single disfavored class* of former federal

officers or employees which includes: all recipients of military retired pay; all retired members of the PHS, NOAA, Foreign Service, and Article III judiciary; certain retired claims court judges, bankruptcy judges and magistrates; and certain retired members of the CIA.[16] The Kansas classification scheme does not, however, recognize or endorse any distinctions -- except source of compensation -- that can be selectively compared in order to justify discrimination. Instead, each member of this class of federal officers and employees receives disfavored tax treatment solely because KITA does not recognize the "source" of their

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16 Claims court judges, bankruptcy judges and magistrates who retire under either the Civil Service Retirement and Disability System [5 U.S.C.A. § 8331 *et seq.* (West 1980 and Supp. 1991)] or the Federal Employees' Retirement System [5 U.S.C.A. § 8401 *et seq.* (West Supp. 1991) ("FERS")] are entitled to an exemption under Kan.Stat.Ann. § 79-32,117(c)(vii) (Supp. 1990) because their retirement pay is received from the "civil service retirement and disability fund." However, Claims Court judges who have retired or elect to retire under 28 U.S.C.A. § 178 (West Supp. 1991) receive retirement pay from the Claims Court Judges Retirement Fund which is fully taxable in Kansas because Kan.Stat.Ann. § 79-32,117(c) does not recognize this federal "source" of retirement pay as the basis for an exemption. Likewise, bankruptcy judges and magistrates who have retired or elect to retire under 28 U.S.C.A. § 377 (West Supp. 1991) receive retirement pay from the Judicial Officers' Retirement Fund which is fully taxable in Kansas because Kan.Stat.Ann. § 79-32,117(c) does not recognize their "source" of retirement pay as the basis for an exemption.

Members of the CIA who retire or elect to retire under FERS in accordance with Title III of the Central Intelligence Agency Retirement Act of 1964 [50 U.S.C.A. § 403 note (West 1991) (Title III, §§ 301 and 307)] receive tax exempt treatment under KITA because their retirement benefits are paid from the "civil service retirement and disability fund." Kan.Stat.Ann. § 79-32,117(c)(vii). However, members of the CIA who retire under Title II of the Act receive retirement pay from the Central Intelligence Agency Retirement and Disability Fund [50 U.S.C.A. § 403 note (Title II, §§ 202 and 211)] which is fully taxable because Kan.Stat.Ann. § 79-32,117(c) does not recognize this federal "source" of retirement pay as the basis for an exemption.

Differential tax treatment of these federal retirees is not merely fortuitous; rather, it highlights the fact that the source of compensation alone is the basis of discrimination.

retirement pay as the basis for an exemption. The Kansas tax system, therefore, impermissibly erects a classification -- based entirely on source -- which uniformly burdens all federal retirees who must pay tax regardless of the nature, characterization or funding of their federal retirement pay. *Cf. Phillips Chemical Co.*, 361 U.S. at 384 [rejecting the State's proffered justification where the offensive tax statute "impose[d] its burdens on all federal lessees" in the disfavored class without regard to alleged differences in leasing activities].

Since many members of the disfavored class undoubtedly receive retirement pay which cannot be characterized as "reduced current compensation for reduced current services," an evenhanded application of this rationale cannot justify the discriminatory classification scheme under KITA. *See Davis*, 489 U.S. at 816-817 [rejecting Michigan's rationale for differential treatment since its uniform application to all members of the favored and disfavored classes would justify an exemption for some retired federal employees and taxation of some retired state employees]. If Kansas truly intended to account for differences in the nature or characterization of retirement pay, it would not discriminate based on the source of payment and it would not tax any federal retirees in the disfavored class who receive deferred compensation. But KITA does both.

In *Davis*, after observing that "the amount of [federal civil service] benefits to be received in retirement is based and computed upon the individual's salary and years of service," this Court expressed "no difficulty concluding that civil service retirement benefits are deferred compensation for past years of service rendered to the Government." 489 U.S. at 808. As a consequence, such federal retirement benefits are squarely entitled to the protection of 4 U.S.C. § 111. *Id.* This analysis reflects a realistic view that, with respect to the nondiscrimination clause of Section 111, retirement compensation "based and computed upon the individual's salary and years of service" is protected, and that federal retirement benefits which bear these essential features are likewise entitled to protection from discrimination "because of the

source of the pay or compensation."

Nevertheless, many forms of federal civilian retirement benefits are taxed under KITA even though they share the essential characteristics of deferred compensation and have never been characterized as compensation for current service. *See, e.g.*, Pub. L. 88-643, Title II, § 221(a), 78 Stat. 1043 (1964), *reprinted in* 50 U.S.C.A. § 403, note, Title II, § 221(a) (West 1991) [retirement annuities under the CIA retirement and disability system are based on each participant's highest average basic salary and years of service]; 22 U.S.C.A. § 4046(a) and § 4071d(b)(2) (West 1990 and Supp. 1991) [Foreign Service retirement benefits for career and non-career members are based on the highest average basic salary received and years of service]; 42 U.S.C.A. § 212(a)(4) and (6) (West 1991) [PHS retired pay is calculated in accordance with basic pay and highest grade held]; 33 U.S.C.A. § 853o(a) (West 1986 and Supp. 1991) [NOAA retired pay is calculated in accordance with basic pay and highest grade held].[17] If the discriminatory classification created by Kan.Stat.Ann. § 79-32,117(c) truly intended to account for actual or perceived differences in the nature of retirement income, however, these federal civilian retirees would not be taxed. *See Davis*, 489 U.S. at 817.

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17 Officers or employees of the PHS and NOAA participate in retirement systems which are similar in nature to the military retirement system. *See* STAFF OF HOUSE COMM. ON ARMED SERVICES, 100TH CONG. 1ST SESS., *Report on Title 37, United States Code: Pay and Allowances of the Uniformed Services (As Amended Through April 3, 1987) and Related Material 160* (Comm. Print 1987). However, PHS retirees have not been subject to involuntary recall to active duty for almost 40 years. *Cf.* 42 U.S.C.A. § 212(c) and § 217 (West 1991) [authorizing involuntary recall only when the President has declared the PHS as a military service in time of war or national emergency] *with* Exec. Order No. 10,367, 17 Fed. Reg. 5929 (1952) [returning the PHS to its status as a non-military uniformed service]. No comparable statute appears to expessly authorize involuntary recall of NOAA retirees to active duty. *See* 33 U.S.C.A. § 851, *et seq.* (West 1986 and Supp. 1991). Therefore, it cannot be reaslitically suggested that PHS or NOA retired pay is granted in consideration of their availability for recall to active federal service.

Likewise, if the Kansas classification scheme truly intended to treat government retirees who may be recalled to active service differently from those who are not, KITA would do so. But it does not. For example, retirement benefits paid by the United States from the Civil Service Retirement and Disability Fund to retired United States Magistrates are exempt from KITA taxation, *see* Kan.Stat.Ann. § 79-32,117(c)(vii) (Supp. 1990), even though such retirees may be recalled to active judicial service. *See* 28 U.S.C.A. § 636(h) (West Supp. 1991).[18] Furthermore, although retired judges and justices of Kansas are only "relieved of further *active duties* on the court," *see* Kan.Stat.Ann. § 20-2614 (1988) [emphasis added], and "may be designated and assigned to perform such judicial service and duties as such retired justice or judge is willing to undertake," Kan.Stat.Ann. § 20-2616 (1988), their retirement benefits are exempt from KITA taxation. *See* Kan.Stat.Ann. § 20-2618 (1988); Kan.Stat.Ann. § 79-32,117(c)(vii) (Supp. 1990). Conversely, retirement benefits paid by the United States to all retired members of the NOAA and CIA, and to certain retired members of the PHS, Foreign Service and federal judiciary are fully taxed under KITA even though such federal retirees may not be involuntarily recalled to active service. *See, e.g.*, Pub. L. 88-643, Title II, § 271(a), *reprinted in* 50 U.S.C.A. § 403 note (West 1991) [CIA retirees may be recalled to active service only "with the consent of the retired participant"]; 42 U.S.C.A. §§ 212(c) and (g)(3) (West 1991) [PHS retirees

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18 In relevant part, 28 U.S.C.A. 636(h) (West Supp. 1991), provides:

> A United States magistrate who has retired may, upon the consent of the chief judge of the district involved, be recalled to serve as a magistrate in any judicial district council of the circuit within which such district is located. Upon recall, a magistrate may receive a salary for such service in accordance with regulations promulgated by the Judicial Conference, subject to the restrictions on the payment of an annuity set forth in section 377 of this title or in subchapter III of chapter 83, and chapter 84, of title 5 which are applicable to such magistrate. . . .

involuntarily separated after being passed over twice for promotion to a senior grade may never be recalled to active service].[19]

If KITA truly intended to account for differences between contributory and non-contributory public sector retirement systems, as suggested by the Kansas Supreme Court, it would do so. But it does not. For example, retirees of the Kansas board of regents and educational institutions under its management who have made no statutory retirement contributions in accordance with Kan.Stat.Ann. § 74-4925(1)(a) and (4) or § 74-4925b (Supp. 1990) receive retirement benefits that are completely exempt from KITA taxation. *See* Kan.Stat.Ann. § 74-4923(b) (Supp. 1990).[20] Conversely, the retirement systems for members of the CIA and Foreign Service, as well as bankruptcy judges and United States Magistrates covered by 28 U.S.C.A. § 377, are all contributory; yet these classes of federal retirees are fully subject to KITA taxation. *See* Pub. L. 88-643, Title II, § 202 and § 211, *reprinted in* 50 U.S.C.A. § 403 note (West 1991) [CIA]; 22 U.S.C.A. § 4045(a) and § 4071e(a) (West 1990 and Supp. 1991) [Foreign Service]; 28 U.S.C.A. § 377(j) (West 1968 and Supp. 1991) [bankruptcy judges and magistrates]; Kan.Stat.Ann. § 79-32,117(c) [no exemption for these federal retirees].[21]

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19 There is no apparent statutory authorization to involuntarily recall NOAA retirees, retired non-career members of the Foreign Service, retired claims court judges and wholly retired Article III judges and justices.

20 These retirees fund their tax-sheltered annuities through salary reductions rather than out-of-pocket contributions. *See* Kan.Stat.Ann. § 74-4925(4); Kan.Stat.Ann. § 74-4925b. But since salary reductions are not income, these State retirees receive a "double deduction" under KITA by avoiding taxation at the time of each salary reduction and at the time retirement benefits are received.

21 The same can be said about restrictions on retirement activities and double-dipping, age and years of service at retirement, and amounts of retirement income. For example, state and local retirees are subject to our state and federal criminal codes, and may be subject to court-martial jurisdiction under certain circumstances, 10 U.S.C.A. § 802(a)(10) (West 1983), but their retirement pay

The absence of such distinctions is further highlighted by the Kansas tax treatment of federal military retirees who also retire from federal civil service. Every such military retiree is given the option to, in effect, convert his or her military retired pay into a federal civil service retirement annuity under applicable provisions of 5 C.F.R. § 831.301 (1991).[22] Although such military retirees retain their military "status" and remain subject to recall to active duty under 10 U.S.C.A. § 688(a) (West Supp. 1991), § 672(a) (West 1983), or § 675 (West Supp. 1991), their retirement pay is completely exempt from Kansas income taxation for the sole reason that it is received "under the federal civil service retirement system, from the civil service retirement and disability fund." *See* Kan.Stat.Ann. § 79-32,117(c)(vii). This phenomenon clearly underscores that differential taxation of federal military retirement

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is exempt from KITA taxation. State and federal civil service retirees are also subject to conflict-of-interest restrictions prescribed by law, *see, e.g.*, 18 U.S.C. § 207 (1990); 5 C.F.R. § 737 (1991); Kan.Stat.Ann. § 46-233 and § 46-241 (Supp. 1991), but their retirement pay is exempt from Kansas income taxation. Likewise, virtually all classes of retired federal, state and local retirees whose retirement pay is exempt from KITA taxation are subject to restrictions against double-dipping. *See, e.g.*, 5 U.S.C.A. § 8344(a) (West 1980 and Supp. 1991); Kan.Stat.Ann. § 74-4914(6) (Supp. 1991), § 74-4957(5), and § 74-4957a(4) (Supp. 1991); and Kan.Stat.Ann. § 13-14a08. Under the Hiss Act, federal civil servants may forfeit their entitlement to retirement benefits upon conviction of certain criminal offenses, 5 U.S.C.A. §§ 8311 to 8315 (West 1980), but their retirement pay is exempt from Kansas income taxation. All firefighters and law enforcement officers who retire with full benefits at age 50 under 5 U.S.C.A. § 8336(c)(1) (West 1980 and Supp. 1991), Kan.Stat.Ann. § 74-4957(3) or Kan.Stat.Ann. § 13-14a08 receive retirement pay that is tax exempt under KITA, while members of the Armed Forces who retire at the same age receive retirement pay that is fully taxed under KITA. Discriminatory taxation under KITA is clearly not "directly related" to or based upon any of these purported differences between classes of public sector retirees.

22 "An employee or member applying for [a federal civil service] annuity who otherwise meets all conditions for receiving credit for military service, but who is in receipt of retired or retainer pay which bars credit for military service may elect to waive the retired or retainer pay and have the military service added to civilian service for annuity computation purposes." 5 C.F.R. § 831.301(c) (1991).

benefits in Kansas is not directly related to continuing military status in retirement; instead, "source" of compensation is the exclusive basis for discrimination.

The foregoing discussion demonstrates that, like the discriminatory tax scheme struck down in *Davis,* differential taxation in Kansas is not directly related to any significant differences in the nature or funding of retirement benefits, or continuing burdens associated with retirement. Instead, "source" of compensation is the operative key to differential treatment, and no other factor plays any role in the taxation or exemption calculus. *Compare* Kan.Stat.Ann. § 79-32,117(c) (Supp. 1990) *with Davis,* 489 U.S. at 806 and n.2 [quoting Mich. Comp. Laws Ann. § 206.30(1)(f) (Supp. 1988)]. Even if one assumes the propriety of comparing all federal, state and local government retirees who are exempt from taxation with a select subset of federal retirees who are not, neither Congress nor the Kansas Legislature considers military retired pay as current compensation for purposes of taxation. Moreover, no Kansas statutory authority or legislative history establishes any consistent reason for discrimination against federal military retirees except the "source" of their retired pay.

To the contrary, Kan.Stat.Ann. § 79-32,117(a) (Supp. 1990) treats military retired pay, and includes it in the Kansas income tax base, as pension income rather than as wages, salaries or compensation for current service. Since this statute utilizes federal adjusted gross income as "the starting point" to determine "an individual's Kansas income tax liability," Pet. App at 7a, it is significant that military retired pay is taxable under 26 U.S.C. § 61(a)(11) (1988) as ordinary *pension income* when received. *See McCarty,* 453 U.S. at 214 n.7 [citing 26 U.S.C. § 61(a)(11), and 26 C.F.R. § 1.61-11 (1980)]. *See also Strickland v. Commissioner,* 540 F.2d 1196, 1198 (4th Cir. 1976) [gross income includes nondisability military "retirement pay" when received

under § 61(a); citing 26 C.F.R. § 1.61-2(a)(1) and § 1.61-11(a)].[23] Because Kan.Stat.Ann. § 79-32,117(a) incorporates this federal treatment precisely, the Kansas statute also taxes military retired pay as ordinary pension income under 26 U.S.C. § 61(a)(11), rather than as wages, salaries or other compensation for current services.[24] While the Kansas Supreme Court acknowledged that "[f]ederal AGI includes military retirement benefits and state and local retirement benefits, 26 U.S.C. § 61(a) (1988)," Pet. App. at 7a-8a, the opinion below ignored the fact that all of these retirement benefits are includible in federal adjusted gross income -- "from whatever source derived" -- as retirement compensation. *See* 26 U.S.C. §61(a)(9) (1988) [annuities]; § 61(a)(11) (1988) [pensions]. However, since the specific statutory basis for taxing military retired pay as pension

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[23] TREAS. REG. § 1.61-11, 26 C.F.R. § 1.61-11 (1991), provides in relevant part:

> (a) *In general.* Pensions and retirement allocations paid . . . by the Government . . . constitutes gross income unless excluded by law. Usually, where the taxpayer did not contribute to the cost of a pension and was not taxable on his employer's contributions, the full amount of the pension is to be included in his gross income * * * * when amounts are received from other types of pensions, a portion of the payment may be excluded from gross income.

While "pay of persons in the military or naval forces of the United States, retired pay of employees, pensions, and retirement allowances are income to the recipients unless excluded by law," TREAS. REG. § 1.61-2(a), 26 C.F.R. § 1.61-2(a) (1991), this regulation draws express contextual distinctions between these forms of income and "wages" or "salaries" – the traditional benchmarks of current compensation for current service – for income tax purposes.

Other courts have also concluded that military retired pay is taxable as ordinary pension income under Internal Revenue Code § 61(a)(11). *See, e.g., In re Marriage of Schissel*, 292 N.W.2d 421, 427 (Iowa 1980); *Cose v. Cose*, 592 P.2d 1230, 1231 (Alaska 1979).

[24] Federal adjusted gross income consists of gross income, as defined by 26 U.S.C. § 61(a), minus specified deductions. 26 U.S.C. § 62 (1988).

income accordingly rejects its tax treatment as compensation for current services, this latter view of military retired pay does not -- and cannot -- serve as a bona fide reason or justification for tax discrimination.

In addition to the treatment of military retired pay as "pensions" under 26 U.S.C. § 61(a)(11), other provisions of federal and state law relevant to taxation consistently treat military retired pay in the same manner as pension income. For example, the Federal Insurance Contributions Act ["FICA"] levies a tax on "wages" for employment, but it does not tax military retired pay or any other form of pension income. *See* 26 U.S.C.A. §§ 3121(a)(5), (i)(2), (m) and (v)(3) (West Supp. 1991). Similarly, although wages for employment are generally subject to involuntary income tax withholding, state income taxes may not be withheld from military retired pay unless the taxpayer "voluntarily requests such withholding in writing." *See* 10 U.S.C.A. § 1045(a) (West Supp. 1991). Under the Internal Revenue Code, military retirees who fund survivor annuities through reductions in retired pay are also extended the same tax treatment as civil service retirees and other retirees under qualified pension plans. *See* 26 U.S.C. § 122(a) (1988) [gross income does not include such reductions in retired pay]; H.R. Rep. No. 1118, 89th Cong., 1st Sess. 4-5 (1965). Likewise, contributions to an Individual Retirement Account ["IRA"] made with military retired pay do not qualify for an IRA deduction because it is treated as pension income. *See* 26 U.S.C. § 219(f)(1) (Supp. 1989); Weinstein, 6 *Mertens Law of Federal Income Taxation* § 25C.12 at 58 (1988); Pet. App. at 24a-25a. Therefore, it is implausible to suggest that discriminatory treatment under KITA is directly related to any material differences in the nature of military retired pay or that Congress has consented to such differential taxation.

The otherwise consistent tax treatment of military retired pay in the same manner as annuities, pensions and deferred compensation plainly demonstrates that Congress and the Kansas Legislature do not perceive any significant differences in the character or funding of such benefits that would furnish a bona

fide reason or justification for differential taxation of military retirees. Nevertheless, while federal income tax law treats all forms of nondisability retirement income in the same manner regardless of its source, the "source" alone expressly determines whether it is taxable or exempt from taxation under Kan.Stat.Ann. § 79-32,117 (Supp. 1990). As in *Davis*, the Kansas Legislature's intended basis for differential tax treatment, therefore, is revealed by a classification which discriminates against all retired officers or employees of the United States who receive benefits -- regardless of their nature for other purposes or method of funding -- from a federal source which KITA does not recognize as the basis for an exemption. See Kan.Stat.Ann. § 79-32,117(c) (Supp. 1990).

In other relevant and related contexts, the Kansas Legislature also plainly recognizes and treats military retired pay as pension income or deferred compensation rather than current compensation. For example, federal military retirees are not authorized to purchase participating service credit under the Kansas Public Employees Retirement System for any period of "active service" in the Armed Forces which is "the basis for *military pension rights*." Kan.Stat.Ann. § 74-4919h(1) (Supp. 1990) [emphasis added]. *See also* Kan.Admin.Regs. § 80-3-16 (1989) [characterizing military retired pay as "a military longevity pension" in KPERS implementing regulations]. This prohibition was enacted by the Kansas Legislature in 1974 to "preclude the doubling up of benefits under KPERS and the military pension system," *REPORT OF SPECIAL COMMITTEES TO THE 1974 LEGISLATURE, RE: PROPOSAL NO. 22 -- RETIREMENT MATTERS*, 22-13 (1974), and it vividly highlights the legislative belief in Kansas that "military pension rights" are actually based on past military service instead of current service.

Like other forms of pension income or deferred compensation, military retired pay is also divisible as "marital property" in actions for divorce, separate maintenance or annulment in Kansas because the legislature has expressly determined that "[a]ll property owned by married persons"

specifically includes "the present value of any vested or unvested military retirement pay." Kan.Stat.Ann. § 23-201(b) (1988). This treatment of military retirement pay is significant for two compelling and undisputed reasons. First, the "*intent and purpose of the legislature* in adopting subsection (b)" of Kan.Stat.Ann. § 23-201 "*was clearly limited to affecting taxation*" by making the transfer of marital property "a nontaxable event" between co-owners. *Wachholz v. Wachholz*, 4 Kan.App.2d 161, 163-64, 603 P.2d 647 (1979) [legislative history citations omitted and emphasis added].[25]

Second, the legislative characterization and treatment of military retired pay as "property" which becomes "marital property" in proceedings to dissolve marriage rests upon a premise -- that military retired pay is deferred compensation for services performed during past years of marriage -- which repudiates any alleged basis for its consideration as "current compensation." *Cf. McCarty*, 453 U.S. at 221 ["The community property division of military retired pay rests on the premise that that pay, like a typical pension, represents deferred compensation for services performed during the marriage."]. At the philosophical core, these characterizations of military retired pay are diametrically opposed and mutually exclusive. Since military retired pay is generally treated the same as other forms of pension income and deferred compensation for purposes of federal and state income taxation, and domestic property determinations with actual or potential income tax consequences, it is simply inconceivable that discrimination against federal military retirees is based on any unique character of their retirement compensation.

The opinion below acknowledges that the Uniformed

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[25] The opinion of the Kansas Court of Appeals in *Wachholz* has been expressly approved by the Kansas Supreme Court. *See Redmond v. Redmond*, 229 Kan. 565, 629 P.2d 142 (1981). *Cf. Cady v. Cady*, 224 Kan. 339, 581 P.2d 358 (1978) [filing a petition for divorce or separate maintenance creates a species of co-ownership in property acquired before and during marriage which avoids a taxable transfer of such property upon divorce or separation].

Services Former Spouses' Protection Act, Pub. L. No. 97-252, 96 Stat. 730 (1982) ["USFSPA"], authorizes the states to treat the disposable portion of military retired pay as "marital property" and that the Kansas Legislature amended Kan.Stat.Ann. § 23-201(b) in 1987 to do so. Pet. App. at 19a-20a. Since the amendment merely inserted the phrase "including the present value of any vested or unvested military retirement pay," 1987 Kan. Sess. Laws, ch. 120, § 1, this permissible action simply reiterated the settled legislative belief that such pay is a "military pension" or "military longevity pension" based on past years of creditable service. *See* Kan.Stat.Ann. § 74-4919h (Supp. 1990); Kan.Admin.Regs. § 80-3-16 (1989). While Kansas has never previously recognized or endorsed, by statute or legislative history, any view of military retired pay as current compensation earned during retirement, this state policy decision clearly rejected any supposed basis for characterizing or treating military retired pay as anything other than pension income or deferred compensation under state law.

However, in principal reliance upon *Cornetta v. United States*, 851 F.2d 1372, 1382 n.3 (Fed.Cir. 1987), and *United States v. Tafoya*, 803 F.2d 140, 142 n.7 (5th Cir. 1986), the Kansas Supreme Court concluded that "the USFSPA did not change the legal characterization of military retirement pay for any other purpose than cases involving marital property settlements." Pet. App. at 21a and 21a-23a.[26] This view, however, offers no meaningful insight into -- and, in fact, ignores -- whether Kansas "truly intended" to discriminate against federal military retirees on any basis other than the "source" of their pay or compensation.

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[26] In reality, the USFSPA did not change the so-called "legal characterization of military retirement pay" for any purpose. Instead, the Act simply empowers state courts to apply principles of state law in the treatment of disposable military retired pay in actions to dissolve marriage. *See* 10 U.S.C.A. § 1408(c)(1) (West Supp. 1991) ["a court may treat retired pay payable to a member * * * either as property solely of the member or as property of the member and his spouse in accordance with the law of the jurisdiction of such court."].

Nevertheless, the nature of the statutory classification, federal and state statutes relevant to the treatment of military retired pay for purposes of income taxation and domestic property divisions, and the Kansas Legislature's express determination that qualifying years of service in the Armed Forces gives rise to "military pension rights" for purposes of the State retirement system all demonstrate that the inconsistent tax treatment in Kansas is not "directly related to" any "'significant differences'" between the two classes of affected government retirees. *See Davis*, 489 U.S. at 816-817 [citations omitted]; *see also Phillips Chemical Co.*, 361 U.S. at 383-385. Moreover, the unsupported suggestion that existing federal case law involving nontax matters prohibits the Kansas Legislature from characterizing or treating military retired pay *for tax purposes* in the same manner as other federal, state and local government retirement benefits directly conflicts with the mandate of equal tax treatment for retired federal officers and employees set forth in 4 U.S.C. § 111 (1988) and does not give rise to any issue of federal preemption.[27]

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[27] Respondents' suggestion that states are required to characterize and treat military retired pay as "current compensation" for state income tax purposes, Respondents' Brief in Opposition at 7, is entirely without merit. In *McCarty*, this Court expressly refused to decide "whether federal law prohibits a State from characterizing retired pay as deferred compensaton" for any purpose. 453 U.S. at 223. Instead, the *McCarty* decision invoked principles of federal preemption to conclude that "the application of community property law conflicts with the military retirement scheme regardless of whether retired pay is defined as current or as deferred compensation." *Id.* Moreover, the Court specifically relied upon the status of military retired pay as a "personal entitlement" and the grave harm to clear and substantial federal interests in preempting the application of community property law. *McCarty*, 453 U.S. at 224-228 and 232-235. *See also Mansell*, 490 U.S. at 584 [construing the holding and reasoning of *McCarty*]. Therefore, the further undecided suggestion in *McCarty* that military retired pay might be properly viewed as "reduced compensation for reduced current services" in the context of community property divisions, 433 U.S. at 221-222, is pure dicta which has no direct or indirect application to state income taxation of military retired pay.

To the contrary, this Court also specifically recognized in *McCarty* that for purposes of federal income taxation, military retired pay is treated in the same

Under the circumstances, reversal of the judgment below is necessary to enforce the unequivocal mandates of 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity.

D. Differential Taxation of Federal Military Retirees Is Not "Justified By" Any Significant Differences Between the Classes of Favored and Disfavored Government Retirees.

The Kansas Supreme Court held that "[a] state is justified in taxing reduced current compensation paid for reduced current services while not taxing deferred compensation." Pet. App. at 30a. Without explanation, the opinion below simply accepts the "rationale of the federal cases" to support this conclusion, even though none of these decisions involve 4 U.S.C. § 111, intergovernmental tax immunity or discrimination against military retirees. Moreover, the court makes no effort to demonstrate that the treatment of military retired pay as compensation for current service has been endorsed by Congress or the Kansas Legislature for purposes of taxation; that such treatment deals with a proper domestic concern of the State; or that it is directly related to a *legitimate* state interest.

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manner as other forms of non-contributory pension income. 453 U.S. at 214 n.7 [construing 26 U.S.C. § 61(a)(1) and 26 C.F.R. § 1.16-11 (1980)]. In addition, the holding in *McCarty* was promptly overturned by specific legislation to enable the states to treat disposable military retired pay the same as other retirement benefits in actions for marital dissolution. *See Mansell*, 490 U.S. at 584-585 and 594-595; *Id.* at 596-597 [O'Connor J., dissenting]. Since the transfer of property upon divorce may have federal and state income tax consequences depending upon whether the property is jointly or separately owned, *see, e.g., United States v. Davis*, 370 U.S. 65 (1962), enactment of the Former Spouses Protection Act supports an inference that Congress intended the treatment of military retired pay in divorce proceedings to have the same tax consequences afforded pensions and other retirement benefits. Thus, it is implausible that Congress has consented or would consent to discriminatory state taxation of military retired pay in the absence of clear statutory authority or legislative history which establishes otherwise. *See also* 4 U.S.C. § 111; *supra* at 14-15 n.12.

Indeed, Congress does not recognize or endorse any distinctions between federal officers or employees who are entitled to protection from discriminatory state taxation. *See* 4 U.S.C. § 111.[28] In view of the equal treatment objectives of the Public Salary Tax Act of 1939, *see supra* at 14-15 n.12, it is significant that all forms of federal, state and local government retirement benefits, including military retired pay, are subject to substantially the same treatment and burdens of income taxation under the Internal Revenue Code regardless of any actual or perceived differences in their character or method of funding. Given these circumstances, the Kansas Supreme Court's stated reliance upon differences in the nature or funding of compensation to justify tax discrimination conflicts with the intent of Congress that military retirees receive the same tax treatment as all other federal, state and local government retirees. To paraphrase *Davis*:

> It is difficult to imagine that Congress consented to discriminatory taxation of the pensions of retired [members of the Armed Forces] while refusing to permit such taxation of [its retired civil service] employees, and nothing in the statutory language or even in the legislative history [behind 4 U.S.C. § 111] suggests this result.

489 U.S. at 810. To the contrary, when Congress amended the Internal Revenue Code to provide military retirees with the same tax treatment afforded civil service retirees and other retirees under qualified pension plans with respect to income, estate and gift taxation of survivor annuities, *see* Pub. L. 89-365, 80 Stat. 32

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[28] Since the plain language of Section 111 does not draw any distinctions between federal civilian and military retirees, several courts have concluded that *all* retired officers and employees of the United States are entitled to the same tax treatment as state and local government retirees. *See, e.g., Hackman v. Director of Revenue*, 771 S.W.2d 77, 79-80 (Mo. 1989) (*en banc*), *cert. denied*, 493 U.S. 1019 (1990); *Bohn v. Waddell*, 164 Ariz. 74, 790 P.2d 772, 780 (1990), *aff'd on reconsideration*, 807 P.2d 1 (T.C. 1991), *appeal pending*, No. 1 CA-TX 90-029 (Ariz. App. 1991).

(1966), it clearly endorsed the supporting legislative history, which states:

> Your committee believes that members (or former members) of the Uniformed Services should be treated essentially the same as retirees under the civil service program and other qualified pension or annuity plans. Your committee has concluded that *there is no substantial grounds for distinguishing the tax treatment of the plan for the uniformed services from these other plans* * * * * As a result, your committee has concluded that these uniformed services retirees should be treated in the same manner as pensioners under qualified plans.

H.R. Rep. No. 1118, 89th Cong. 1st Sess. 4-5 (1965) [emphasis added]. Therefore, regardless of whether military retired pay may be properly viewed as current compensation for other distinct purposes, it is not significantly different for tax purposes to justify discriminatory state income taxation.

Although the Kansas Supreme Court focused its attention almost exclusively upon alleged differences between the military and civilian retirement systems in its effort to uphold the State tax scheme, it erred in ignoring similarities vital to proper application of statutory and constitutional principles of intergovernmental tax immunity. For example, since entitlement to military retired pay is generally predicated upon at least 20 years of service, *Mansell*, 490 U.S. at 583, and the amount of retired pay "is calculated on the basis of the number of years served and rank achieved," *McCarty*, 453 U.S. at 214, like other forms of government retirement income, it possesses significant features of deferred compensation for purposes of the tax immunity doctrine. *Cf. Davis*, 489 U.S. at 808. In *McCarty*, after observing the truth that military retired pay "bears some of the features of deferred compensation," the Court significantly acknowledged:

> The amount of retired pay a service member receives is calculated not on the basis of continuing duties he actually performs, but on the basis of years served on active duty and the rank obtained prior to retirement. . . . Furthermore, should the service member actually be recalled to duty, he receives additional compensation according to the active duty pay scale, and his rate of retired pay is also increased thereafter.

453 U.S. at 223 n. 16 [citations omitted].

Because military retired pay is not based on any affirmative duties actually performed in retirement, it is hardly comparable for tax purposes to "wages" or "salaries" earned by any officers or employees performing active government service. Indeed, upon retirement, members of the Armed Forces: lose their entitlement to active duty pay and allowances, 37 U.S.C. § 204(a), § 402(a), § 403(a) (1988); acquire the status of a "retired" officer or employee; and become entitled to "retired pay" in accordance with governing federal statutes, *see McCarty*, 453 U.S. at 214. While military retirees may receive cost-of-living increases in retirement, *see* 10 U.S.C.A. § 1401a(b) (West Supp. 1991), retired pay may not generally be "recomputed to reflect any increase in the rates of basic pay for members of the armed forces." *Id.* at § 1401a(a).[29] Relying upon some of these

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[29] In *United States v. Tyler*, 105 U.S. 244 (1881), this Court held that a retired Army Captain was entitled to a statutory pay increase "for every period of five years' service" because he was "by law a part of the army;" he could be "assigned by [his] superior officers to specified duties by detail as other officers are;" and he could be tried and dismissed from the service by court-martial for breaches of the rules and articles of war. *Id.* at 244-246. The narrow question presented for decision was simply whether Captain Tyler was deemed to be "in the military service" for purpose of a pay increase awarded every five years to all persons in the service. *Id.* at 244.

At the time of *Tyler*, it appears that retired officers could be assigned by superior officers "to specified duties by detail" in the same manner as officers

factors to invalidate the Colorado tax scheme in effect before *Davis*, the Supreme Court of Colorado persuasively and unanimously concluded:

> [T]he overall scheme of the [military] retirement benefits is akin to a civilian pension earned by the service member for years of active service. For example, in the army, members are not allowed to draw retirement pay unless they have served a specified period of active service, normally twenty years. 10 U.S.C. § 3911 (1988). Retirement terminates the right to active duty pay and allowances. 37 U.S.C. § 204(a) (1988). In addition, the amount of retirement pay is directly

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serving on active duty and that officers required to perform "less than full service" following retirement would receive no additional compensation for actual duties assigned. 104 U.S. at 246. In the contemporary Armed Forces, however, it does not appear that military retirees may be assigned to duties by detail or otherwise unless they are first recalled to active duty by the Secretary of their service. Moreover, in the event of recall, military retirees are now paid in accordance with the active duty pay scale and, upon returning to retired status, the amount of their retired pay may be increased based on such additional period of active service. Therefore, contemporary retired pay is much more comparable to pension income than it was more than 110 years ago.

In addition, the statutory basis for Captain Tyler's pay increase, then uniformly applicable to officers on active duty and those who retired from active service only, was legislatively abandoned in 1958. *See* STAFF OF HOUSE COMM. ON ARMED SERVICES, 100th Cong., 1st Sess. *Report on Title 37, United States Code: Pay and Allowances of the Uniformed Services (As Amended Through April 3, 1987) and Related Material* 162-163 (Comm. Print 1987) [Pub. L. 85-422 terminated the practice of increasing retired pay according to increase in the active duty pay scale after a one-time adjustment of 6 percent to the retired pay of all personnel on June 1, 1958]. Since 1980, increases in military retired pay have been determined using the same method, effective date and payment schedule used for federal civil service retirement pay increases. *Id.* Since military retired pay increases parallel the increases in civil service annuities as a result of specific congressional action, this furnishes additional evidence that these forms of retirement compensation are viewed by Congress as substiantially comparable.

> proportional to the number of years spent on active duty. 10 U.S.C. §§ 3926, 3991, 6325-6327, 8929 (1988).

Kuhn v. State of Colorado, 817 P.2d 101, 108 (Colo. 1991) (en banc).

In view of the substantial similarities between the military retirement system and other government retirement systems, it is not surprising that Congress and the Kansas Legislature have generally regarded military retired pay as comparable to other forms of retirement income for purposes of income taxation and marital property determinations in state divorce proceedings which may have tax consequences. It is also not surprising that the Kansas Public Employees Retirement System considers military retired pay as a "military pension," Kan.Stat.Ann. § 74-4919h(1) (Supp. 1990), or a "military longevity pension," Kan.Admin.Regs. § 80-3-16 (1989), in prohibiting military retirees from purchasing additional service credit under the State retirement system. *Id.* It is, therefore, inconceivable that tax discrimination against military retirees in Kansas is justified by any significant differences between the classes of retired government employees affected by the State's differential tax scheme.

Despite these fundamental similarities with other forms of government retirement income, and the absence of any relevant differences recognized by statute or otherwise, Kansas discriminates against both military and civilian retirement benefits because they are derived from a federal source which is not specifically exempt from state income taxation under Kan.Stat.Ann. § 79-32,117(c) (Supp. 1990).

The Kansas Supreme Court's discussion of intergovernmental tax immunity is also notably silent with respect to any legitimate state interest or proper domestic concern which is promoted by its alleged justification for discrimination. Nevertheless, the discriminatory exemption scheme exists as part and parcel of the State's retirement system, the primary purpose

of which is to allow employees to retire "from *active service* without prejudice" or hardship, to provide for "old age, death and termination of employment," and to effect "economy and efficiency in the administration of government affairs." Kan.Stat.Ann. § 74-4901 (1985) [emphasis added]. *Cf.* Pet. App. at 34a-35a [discussing these purposes only in conjunction with a state constitutional issue evaluated under the rational basis test]. By offering tax-exempt retirement benefits, Kansas plainly seeks to advance its interest "in hiring and retaining qualified employees," Pet. App. at 35a, and in protecting its employees from economic hardship upon retirement, while minimizing its employment costs.

Recognizing the impermissible and offensive nature of promoting rational state interests through discrimination against the United States and its officers or employees, this Court cogently observed in *Davis*:

> In order to provide the same after-tax benefits to all retired state employees by means of increased salaries or benefit payments instead of a tax exemption, the State would have to increase its outlays by more than the cost of the current tax exemption, since the increased payments to retirees would result in higher federal income tax payments in some circumstances. *This fact serves to illustrate the impact on the Federal Government of the State's discriminatory tax exemption for state retirees. Taxes enacted to reduce the State's employment costs at the expense of the federal treasury are the type of discriminatory legislation that the doctrine of intergovernmental tax immunity is intended to bar.*

489 U.S. at 815 n.4. [emphasis added]. Like the Michigan statute struck down in *Davis*, the Kansas source-related classification violates 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity by unjustifiably reducing the State's employment costs at the expense of the United States and its retirees who are subject

to differential taxation.

The unjustified discrimination against military retirees by the Kansas tax scheme is especially egregious because it carries the potential to frustrate the objectives of Congress in establishing a military retirement system. Pursuant to express grants of constitutional authority "Congress has enacted a military retirement system designed to accomplish two major goals: to provide for the retired service member, and to meet the personnel management needs of the active military forces." *McCarty*, 453 U.S. at 232-233. Whatever differences which may exist between the military retirement system and other retirement systems are the result of considered determinations made by Congress in furtherance of our national interests [*see* U.S. Const. art. I, § 8, cls. 12, 13, 14 and 18] and do not involve proper domestic concerns of any State in the Union. If the States are permitted to discriminate against military retirees in matters of income taxation, the value of a military career may be viewed as less attractive than careers in other forms of government or private service and the active service needs of the Armed Forces could suffer through the loss of valuable manpower. Likewise, the comparative reduction in retired pay from discriminatory taxation might not only discourage retirement, but also give some service members a positive incentive to remain on active duty. *Cf. McCarty*, 453 U.S. at 235 ["Congress has determined that a youthful military is essential to the national defense; it is not for States to interfere with this goal by lessening the incentive to retire created by the military retirement system"]. Therefore, since Congress has not consented to discriminatory taxation of military retired pay, the differential tax system in Kansas treads upon the prerogatives of the Federal Government and poses a potential threat to the attainment of its national objectives recognized in *McCarty*, 453 U.S. at 232-235.

Under the circumstances, differential taxation of military retired pay is not justified by any significant or permissible differences between federal military retirees and other government retirees. Therefore, the Kansas Income Tax Act violates 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental

immunity, as reiterated and applied in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989), by favoring retired officers and employees of the State and its political subdivisions over retired officers and employees of the United States Armed Forces.

CONCLUSION

The judgment of the Supreme Court of the State of Kansas should be reversed and this case should be remanded for further proceedings so that the Petitioners, and members of the designated class of affected federal retirees, can secure appropriate relief from unconstitutional Kansas income taxation.

Respectfully submited,

JOHN C. FRIEDEN
KEVIN M. FOWLER*
FRIEDEN, HAYNES & FORBES
400 SW 8th, Suite 409
Topeka, Kansas 66603
(913) 232-7266

* *Counsel of Record*

TERENCE A. LOBER
DAVIS, BEALL, MCGUIRE &
THOMPSON, CHARTERED
1117 Cherokee Street
Leavenworth, Kansas 66048
(913) 682-3822

KENTON C. GRANGER
RAYMOND L. DAHLBERG
ANGELA K. GREEN
NIEWALD, WALDECK &
BROWN, P.C.
9401 Indian Creek Parkway
Corporate Woods,
Building 40,Suite 550
Overland Park, Kansas 66225
(913) 451-1717

ROGER M. THEIS
9411 Shannon Way Court
Wichita, Kansas 67206
(316) 634-0418

Counsel for Petitioners